Supreme Court, U.S.
FILED
APR 18 1991
OFFICE OF THE CLERK

No. 90-741

In the
Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,
PETITIONER,
v.
LOUIS L. TIMM, JOHN NEIUWLAND AND FLOYD M. CHILDS, TRUSTEES OF THE UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., AND JOSEPH L. HENROID, AS TRUSTEE FOR THE ANNETT JACOB TRUST,
RESPONDENTS.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEAL FOR THE TENTH CIRCUIT

Brief of Consumers Education and Protective Association, Inc. as Amicus Curiae in Support of Petitioner

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INTEREST OF AMICUS CURIAE

Amicus Consumer Education and Protective Association, Inc. (CEPA) is an organization of consumers which is dedicated to advancing the cause of consumer rights. CEPA considers the remedies afforded debtors under the Bankruptcy Code to be an important means of ameliorating the human costs which arise in an economic system in which business failures, with concomitant layoffs and unemployment, regularly occur.

Very often individuals buy homes with the assistance of purchase money mortgages which are adequately secured by the value of their homes. These same people, at a later date, may have their homes encumbered by junior liens in order to finance purchases of consumer goods or business ventures. The creditors are aware when they take these liens that there is little or no equity to support

them. The creditors do so solely for the leverage which the liens provide.

With the use of 11 U.S.C. §506, chapter 7 debtors can void these undersecured mortgages and can resume making payments on their purchase money mortgages, thus preserving their homes. If these individuals are barred from utilizing §506(d), they will not be able to effectuate their discharge; they will be forced to pay the junior undersecured lienholders under threat of foreclosure on their homes even when the creditor's lien is without value.

The Court's ruling in this case is critical to individual debtors who wish to retain their homes and get a true fresh start in bankruptcy.

SUMMARY OF ARGUMENT

The plain language of §506(d) of the Bankruptcy Code dictates that an undersecured lien on property in a chapter 7 case is void whether or not the property has been abandoned. This plain meaning is consistent with the purpose of §506(d), with its role in the Code's claim allowance scheme, and with providing debtors a fresh start.

The rationale relied upon by the lower court in deviating from the language of the statute would, if followed, lead to nonsensical results, including the evisceration of the debtor's right of redemption and the elimination of an undersecured creditor's ability to participate in the distribution of the estate's assets in a chapter 7 case.

The decision of the lower court should be reversed.

ARGUMENT

I. THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE PERMITS A CHAPTER 7 DEBTOR TO VOID LIENS ON REAL PROPERTY TO THE EXTENT THE LIENS EXCEED THE PROPERTY'S VALUE WITHOUT REGARD TO WHETHER THE PROPERTY HAS BEEN ABANDONED.

A. This Court's Inquiry Need Go No Further Than An Examination Of The Plain Language of the Code

The issue in this case is whether, pursuant to 11 U.S.C. §506(d), chapter 7 debtors may void liens on real property which has been abandoned by the trustee, to the extent the fair market value of the property is less than the amount of the liens.

As in all cases of statutory construction, the starting point in this case must be the statutory language itself. Pennsylvania Department of Public Welfare v. Davenport, 110 S.Ct. 2126, 2130 (1990); United States v. Ron Pair Enters., Inc., 109 S.Ct. 1026, 1030 (1989). "The plain meaning of legislation should be conclusive, except in

the rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of the drafters." Ron Pair, 109 S.Ct. at 1031 (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)).

This is especially true in the bankruptcy context. Congress worked on the formulation of the Bankruptcy Code for nearly a decade. The Code was established to modernize the bankruptcy laws and as a result made major changes in the substantive laws of bankruptcy. Ron Pair, 109 S.Ct. at 1030. This legislative history bolsters the need to interpret the Bankruptcy Code by its plain language, manifesting Congressional intent. As this Court stated in Ron Pair, a decision concerning §506(b) of the Bankruptcy Code:

> In such a substantive overhaul of the system, it is not appropriate or realistic to expect Congress to have explained each step it took. Rather, as

> long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain meaning of the statute.

Ron Pair, 109 S.Ct. at 1030.

In this case, the language of the Code is clear. It dictates that in a Chapter 7 case, a lien on a debtor's real property is void to the extent it is undersecured so long as the lien is brought to the attention of the bankruptcy court. That the property is or may be abandoned in the future under §554 of the Code is irrelevant. 11 U.S.C. §§103(a), 506(a), 506(d).

Section 506 "governs the definition and treatment of secured claims, i.e., claims by creditors against the estate that are secured by a lien on property in which the estate has an interest." Ron Pair, 109 S.Ct. at 1029. The statute makes no distinction between liens on real property and liens on personal property. See In re Lindsey, 823 F.2d 189,

190 (7th Cir. 1987). "Subsection (a) of §506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured." Ron Pair, 109 S.Ct. at 1029; In re Hart, 923 F.2d 1410, 1413 (10th Cir. 1991); Gaglia v. First Federal Savings & Loan Ass'n., 889 F.2d 1304, 1308 (3rd Cir. 1990); Lindsey, 823 F.2d at 190; see In re Folendore, 862 F.2d 1537, 1539 (11th. Cir. 1989). To the extent the lien exceeds the value of the property, the lien secures a claim that is not an "allowed secured claim" and is void. 11 U.S.C. §506(d);[1] Gaglia, 889

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[1] 11 U.S.C. §506(d) has two limitations on voiding liens. Liens are not void if (1) the underlying claim is disallowed under §502(b)(5) or §502(e), which deal with unmatured debt and co-debtor claims, or (2) the claim is not an allowed secured claim due only to the failure of any party to file a proof of claim. Neither exception is relevant to the instant case.

F.2d at 1308; Folendore, 862 F.2d at 1538-39, (11th Cir. 1989).

Section 103(a), entitled "Applicability of Chapters", states:

> [C]hapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title.

Section 506 is found in chapter 5 of the Bankruptcy Code. Therefore the plain meaning of the Code's language unambiguously dictates the bifurcation of claims into secured claims and unsecured claims in all bankruptcy chapters, including chapter 7 bankruptcy cases. Hart, 923 F.2d at 1415 (chapter 13); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123, 127-28 (3d Cir. 1990) (chapter 13); Gaglia 889 F.2d at 1311 (chapter 7); In re Hougland, 886 F.2d 1182, 1183, (9th Cir. 1989) (chapter 13); Folendore, 862 F.2d at 1538 (chapter 7); see In re Tarnow, 749 F.2d 464, 465 (9th Cir. 1984) (chapter 11). There is

simply nothing in the Bankruptcy Code which provides any authority for making §506(d) inapplicable to liens on property which has been abandoned nor any basis to find it less applicable in chapter 7 than in the reorganization chapters. See Gaglia, 889 F.2d at 1308.

Since the statute's language is plain, "the sole function of the courts is to enforce it according to its terms." Ron Pair, 109 S.Ct. at 1030 (quoting Caminetti v. United States, 242 U.S. 470, 485 (1917)).

B. If it Were Congress' Intent to Make §506 Inapplicable to Abandoned Property in a Chapter 7 Case it Would Have Placed The Restriction in the Code.

If Congress wished to restrict the applicability of §506 in a chapter 7 case to property not abandoned by the estate, Congress surely would have drafted such limiting language into the Bankruptcy Code itself. Congress has done so in chapter 11 of the

Bankruptcy Code where pursuant to §1111(b)(2),[2] undersecured nonrecourse creditors[3] may elect to override §§1111(b)(1)(A) and 506 (the combined effect of which provides nonrecourse undersecured creditors with a secured claim for the value of their collateral and with an unsecured recourse claim for the deficiency). Instead

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[2] Sections 1111(b)(1)(A) and (2) state in relevant part:

> (b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse. . .
>
> (2) If such an election is made, then **notwithstanding section 506(a) of this title**, such claim is a secured claim to the extent that such claim is allowed. (emphasis added).

[3] Nonrecourse creditors are limited to their pledged collateral to satisfy their claims and may not assert any deficiency claims against the debtor. Norton Bankruptcy Law & Practice §58.01 (1990).

these creditors may elect to waive their unsecured deficiency claims and have their claims treated as if they were fully secured in a debtor's chapter 11 plan. Norton Bankruptcy Law & Practice §58.02 (1990).

As the Third Circuit Court of Appeals in Gaglia observed:

> Section 1111(b)(1) is carefully drawn and uses specific, precise language. It demonstrates that Congress knew how to exempt certain creditors from the operation of §506, and could do so with precision. Considering this careful drafting, we are unwilling to read into §506 an exemption for an undersecured creditor when the property securing his claim is not liquidated in Chapter 7 proceedings.

Gaglia, 889 F.2d at 1311.

The absence of such limiting language in chapter 7 of the Bankruptcy Code indicates that Congress did not envision any exception to the applicability of §506 in chapter 7 cases. Nor did it include any limitation on

the applicability of §506 to liens on abandoned property.

II. THE BANKRUPTCY CODE'S PURPOSES AND POLICIES ARE EFFECTUATED BY APPLYING THE PLAIN MEANING OF 11 U.S.C. §506

As is demonstrated above, the plain meaning of 11 U.S.C. §506(d) dictates that an undersecured lien is void in a chapter 7 case even when that lien is on abandoned property. This result is also dictated by the purpose and operation of 11 U.S.C. §506(d) and by its role in the claim allowance scheme.

Contrary to the assertion of the court below, 11 U.S.C. §§506(a) and (d) are not in the Code simply to "facilitate valuation and distribution in the reorganization chapters of the code." In re Dewsnup, 908 F.2d 588, 591 (10th Cir. 1990). They are also necessary to permit the final "adjustment of the debtor ... creditor relationship." 28 U.S.C. §157(b)(2)(O). This adjustment is essential

to the two basic purposes of a chapter 7 bankruptcy - to accomplish a fair and equitable distribution of the assets of the debtor to secured and unsecured creditors and to provide the debtor with a fresh start. Folendore, 862 F.2d at 1540; Grogan v. Garner, 111 S.Ct. 654, 659 (1991). Both of these purposes require the voiding of any lien to the extent it is determined to be without validity or worth by the bankruptcy court. This result is also dictated by the role which §506 plays in the claim determination and allowance process contained in the Code.

A. The Voiding of an Undersecured Lien on Abandoned Property in a Chapter 7 Case is Consistent With the Fair and Equitable Distribution of the Assets of the Estate

One significant motivation for enacting §506 was to address the manner in which creditors who were undersecured lienholders at the time of the petition would be treated in bankruptcy - both in liquidation cases and in reorganization cases." Congress, by enacting §506, struck a balance between competing interests of various parties to a bankruptcy proceeding.

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[4] It is explicit in §4-402 of the bill drafted by the Commission on the Bankruptcy Laws of the United States, which originated the concept of bifurcating undersecured claims now found in §506(a), that the undersecured part of a claim is unsecured in both liquidation and reorganization cases. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess., Pt. II (1973). The concept that bifurcating claims applies to both liquidations and reorganizations was carried forward in all subsequent bills. See "Legislative History of Section 506" 3 Collier on Bankruptcy ¶506.3 (15th ed. 1990).

The legislators were concerned that a creditor who was undersecured at the time of the petition should not be excluded from participating in the general distribution of the estate. At the same time Congress did not want the secured creditor to be paid twice - once from the realization of its interest in the security and a second time from the proceeds of the distribution. See S. Rep. No. 95-989, 95th Cong. 2d Sess. 68 (1978). Congress also intended that the debtor, and not the creditor, benefit from the increase in equity ownership resulting from the debtor's using postpetition assets to pay down prepetition liens.[5] Gaglia, 889 F.2d at 1309.

Section 506(a) provides a means of accomplishing these goals by creating a

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[5] See the discussion of the role §506(d) plays in preserving the debtor's fresh start in part II. C. below.

mechanism which "separates an undersecured creditor's claim into two parts: He has a secured claim to the extent of the value of his collateral, and he has an unsecured claim for the balance of his claim." * Section 506(d) completes the solution by voiding the creditor's lien to the extent it exceeds the value of the collateral.

The bifurcation of the claim into secured and unsecured portions allows the undersecured creditor to look to its collateral for payment of its claim up to the value of the collateral and to participate with the other unsecured creditors in the distribution of the estate. The creditor can only participate in the

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* S. Rep. No. 95-989, 95th Cong. 2d Sess. 68 (1978). The Senate version of §506(a) of the Code, was ultimately enacted as part of amended H.R. 8200. See §506(a) of H.R. 8200, amendment adopted on September 28, 1978 at 124 Cong. Rec. to H. 11,057 (daily ed. Sept. 28, 1978).

distribution to the extent its claim exceeds the value of the collateral. Thus the creditor is precluded by the §506(a) bifurcation from receiving double payment of the **secured** portion of its claim. The voiding of the lien under §506(d) prevents the undersecured creditor from receiving double payment on the **unsecured** portion of its claim.

The principle which motivated Congress to provide for the bifurcation of undersecured claims is the same whether the property subject to the security is abandoned or not. By holding that §506(a) never comes into effect to bifurcate a claim if property has been abandoned, the court below potentially deprived it of almost all meaning and clearly defeated its purpose. If property is subject to liens which exceed its value, the property is virtually always abandoned in a chapter 7 case sooner or later. A trustee could never

realize any funds for the estate by selling it, and even if the property is not affirmatively abandoned during the case, it is normally deemed abandoned upon the closing of the case. 11 U.S.C. §554(c).

If the holding of the court below were adopted, an undersecured creditor would be precluded from participating in the distribution of the assets of the estate in every chapter 7 case. An undersecured creditor could never have an allowed unsecured claim because, due to the abandonment or potential abandonment of the overencumbered property, the undersecured creditor's claim could not be bifurcated under §506(a). This is clearly inconsistent with how §506 of the Code was intended to operate.

B. The Role of §506 in the Overall Claim Allowance Scheme of the Code Dictates That §506(d) is Available to Void the Undersecured Portion of a Lien on Property That has Been Abandoned

Section 506, entitled "Determination of secured status", is part of the claims determination scheme of the Code. In re Tanner, 14 B.R. 933, 936 (Bankr W.D. Pa. 1981); see, Wilson, 895 F.2d at 126-127 (character of a creditor's claim is determined by reference to §506). It is found in Subchapter I of Chapter 5 entitled "Creditors and Claims". The sections of this subchapter collectively define the procedures and the substantive standards under which claims are filed, determined, and classified under all chapters of the Code.

When a claim is brought to the attention of the bankruptcy court, the court is constrained by §502(b) to determine "the amount of such claim in lawful currency of the

United States **as of the date of the filing of the petition**" and to allow the claim "in such amount" except to the extent the claim must be disallowed under subsections (1) - (7) of §502(b). 11 U.S.C. §502(b)(emphasis added). After the claim is determined and allowed it is then subject to classification under other sections of Subchapter I.

With some exceptions not here applicable', the Code contemplates a claims process that freezes the respective rights of the debtor and his or her creditors as of the date of the petition. See Tanner, 14 B.R. at 937. Events subsequent to the petition date, such as abandonment, are not relevant to the determination of claims against the debtor or against the property of the debtor. See 11 U.S.C. §502(b).

See e.g. 11 U.S.C. §§ 502(f)-(i).

Section 506 provides the means for classifying claims that have been "allowed" under §502 into "allowed secured claims" and defines what is an allowed "secured claim". Section 506(a) bifurcates "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest" into secured and unsecured components. 11 U.S.C. §506(a). Just as the claim is determined and allowed under §502(b) "as of the date of the filing of the petition", the allowed claim is treated as secured or unsecured to the extent the claim is secured by a lien on property in which the estate has an interest "as of the date of the filing of the petition." The subsequent abandonment of the property is irrelevant.

Because §506 effects secured creditors, unsecured creditors and the debtor, the Code permits each of these participants to bring the provisions of §506(d) into play even when

the others fail to do so. 11 U.S.C. §§506(d)(2) and 501(c); Bankruptcy Rule 3004; Gaglia, 889 F.2d at 1307 and 1309. The use of §506 in a Chapter 7 case was explained by Judge Posner, writing for the Seventh Circuit Court of Appeals as follows:

> The presence of the mortgagees in the bankruptcy proceeding requires comment, in view of the old saw (which, as this case shows, is no better than a half-truth) that liens pass through bankruptcy unaffected. See e.g. Tarnow, 749 F.2d 464, 466 (7th Cir. 1984). A lienor need not, in order to enforce his lien, file a claim in his debtor's bankruptcy proceeding, though if he does not he loses the chance of enforcing any deficiency judgment against the assets of the bankrupt estate. Since the Lindseys had no assets other than those secured by the mortgages, the mortgagees had no incentive to seek a deficiency judgment, hence no incentive to file a claim in bankruptcy. If, therefore, liens truly passed through bankruptcy unaffected, the mortgagees would not have been dragged into the bankruptcy proceeding at all, since they were content to foreclose on their liens. But then how are sections 506(a) and (d) provisions that apply only to liens and hurt the lienor -- ever brought into play? One possibility is that they are brought into play only when the lienor wanting to have an unsecured

> claim against the bankruptcy estate to the extent of any difference between the value of his lien and the amount of money owed him by the debtor, has voluntarily filed a claim in bankruptcy. This interpretation, which makes section 506 merely an optional creditor's remedy, is consistent with the notion that liens pass through bankruptcy unaffected, but overlooks the significance of section 506(d) when read together with section 501, which governs proof of claims. Section 501(c) authorizes the debtor as well as the creditor to file a proof of claim including proof of a secured claim under section 506(a). Such a filing not only drags the secured creditor into the bankruptcy proceeding against his will but brings section 506(d) into play, that is, strips down the lien, even if the lienor would have preferred to bypass the bankruptcy proceeding completely.

Lindsey, 823 F.2d at 190-191.

The debtor's ability, independent of the trustee, to bring the provisions of §506(d) into play is additional evidence that Congress intended §506(d) to apply in a Chapter 7 case irrespective of whether collateral has been abandoned. See, Gaglia, 889 F.2d at 1309. Ordinarily, a trustee in a chapter 7 case has no reason to file a proof of claim for a

secured creditor whose collateral has been abandoned under §554. By filing such a claim the trustee would only dilute any distribution to the unsecured creditors by adding the undersecured portion of the lienholder's claim to the total of the unsecured claims.

The debtor however, continues to have an interest in a final determination of the extent of the creditor's claim against the debtor and against his or her property. For example, the debtor may dispute the extent or the validity of the lien under state law and may wish to bring that dispute to the attention of the bankruptcy court. See 11 U.S.C. §502(b)(2); Tarnow, 749 F.2d at 465-456 (when the bankruptcy court allows or disallows a secured claim it also determines validity of the lien).[8] If the provisions of §506 were

[8] The debtor may wish to have the claim determined for additional reasons related to his fresh start. Some of these reasons are discussed in Part II. C below.

unavailable whenever property was abandoned, the debtor would be unable to effectively challenge the claim of an undersecured creditor in a chapter 7 case."[9]

[9] This is evident from an examination of the relationship between 11 U.S.C. §§502 and 506(d). Contrary to the suggestion of the court below, §506(d) is not brought into play only after an allowed claim is bifurcated into secured and unsecured claims under §506(a). See Dewsnup, 908 F.2d at 591-592. Section §506(d) is applicable whenever a secured claim is determined by the bankruptcy court.

Section 506(a) applies only to "allowed claims". In contrast, a lien is void under §506(d) to the extent the "lien secures a claim against the debtor that is **not an allowed secured claim** ...." 11 U.S.C. §506(d) (emphasis added). When a lien secures a claim against the debtor that is disallowed pursuant to §502(b) the lien secures a claim against the debtor that is "not an allowed secured claim" and is void under 506(d). Thus, if a claim secured by a lien is contested "on the ground that the loan had never been made, or that it had been completely repaid, or that repayment could not be made because the loan was usurious and if the bankruptcy court

(continued...)

This reading of §506(d) would give the holders of the most spurious claims the greatest power to harass the debtor after the bankruptcy and to frustrate the debtor's fresh start. See H.R. Rep. 95-595, 95th Cong., 1st Sess. 124 (1977). This is clearly not what Congress intended. See 11 U.S.C.§524.[10]

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*(...continued)
agreed that the [debtor] had no legally enforceable obligation to the creditor" and disallowed the claim, the lien, pursuant to §506(d), "fall[s] with the claim". Tarnow, 749 F.2d at 465-466.

Under the lower court's reading of §506(d), if the property subject to a lien is abandoned in a chapter 7 case, §506(d) can't apply. Dewsnup, 908 F.2d at 591. The lien on abandoned property that secures a claim that is disallowed would not be void. The debtor would be left to relitigate the validity of the lien in state court.

[10] Section 524(a) of the Code embodies the desire of Congress to insulate the debtor, "especially the 'little guy' who is the subject of the typical 'consumer'... bankruptcy" from the harassment which results when the debtor is left to burdensome litigation in state court to enforce the (continued...)

C. The Role of §506(d) in Effectuating the Debtor's Fresh Start Dictates That it be Applied to Abandoned Property in a Chapter 7 Case

It may at first blush seem harsh to permit debtors to void liens on their real property. This power to void undersecured debt however, merely effectuates the real world marketplace result by duplicating within bankruptcy that which would have occurred outside bankruptcy in a liquidation sale. Gaglia, 889 F.2d at 1308; Lindsey, 823 F.2d at 191. In fact, respondents have conceded that mortgage lenders are not often hurt by the judicially determined value of their secured claim instead of the value actually brought at a foreclosure sale. Brief for Respondents in Opposition to Certiorari at 8-9. A partially

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[10](...continued)
rights which the bankruptcy affords. See 3 Collier on Bankruptcy, ¶524.01[01] (15th ed. 1991). This desire is also manifested by the provisions of §506(d).

or fully undersecured creditor would receive little or nothing from such a sale. Lindsey, 823 F.2d at 191. Avoiding the undersecured portion of a mortgage lien deprives the creditor solely of this empty legal right. Tanner, 14 B.R. at 38.

What apparently disturbed the lower court was that the debtors might be able to keep their farm by paying the creditor the value of the property if §506(d) was applied as written. The court inserted into the Bankruptcy Code a policy of its own invention that undersecured creditors have the right to receive title to the property on which they have undersecured liens at forced sales in order to have the opportunity to speculate upon them. Dewsnup, 908 F.2d at 593. Congress, on the other hand, determined that creditors with secured claims should receive in bankruptcy what their collateral is worth

at the time of the bankruptcy and receive distribution with unsecured creditors for the balance of their undersecured claims.

The Dewsnup court failed to observe that nothing stops these undersecured creditors from attending other forced sales in the debtor's locale and from purchasing similar properties to speculate on. The Bankruptcy Code was simply not written to protect this concern of potential speculators. Accord, Tanner, 14 B.R. at 937. Quite to the contrary, any postpetition appreciation in the value of a debtor's property or reduction in the value of senior liens is to inure to the benefit of the debtor under the fresh start principle and not to undersecured lienholders. E.g. Gaglia, 889 F.2d at 1309; In re Harris, 94 B.R. 832, 836 (D.N.J. 1989); In re Crouch, 76 B.R. 91, 94 (Bankr. W.D.Va. 1987).

The Bankruptcy Code must be interpreted to accomplish its purposes, one of which is to provide debtors with a fresh start." H.R. Rep. 95-595 at 117-8. The 11th Circuit in Folendore addressed the fresh start policy underlying the Bankruptcy Code and the interplay with §506 as follows:

> The whole point of bankruptcy is to provide a debtor with a fresh start. Section 506 allows the debtor the option to begin anew on its former property. Section 506 does not give a debtor his property back as some sort of windfall. It simply permits the debtor to eventually repurchase an equity in it, something the [mortgage lender] admits it has the right to do on any other piece of land.

Folendore, 862 F.2d at 1540.

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[11] In Grogan v. Garner, 111 S.Ct. 654, 659 (1991), this Court reaffirmed "that a central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."' (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

Most often debtors invoke §506 as a preliminary step in their efforts to save their homes from foreclosure. The Gaglia court pointed out how §506 can be of critical importance in this effort:

> While the [creditor] is no worse off than if the property were sold, the [homeowners] may realize significant benefits from lien avoidance. They may be better able to negotiate a repayment schedule with the [creditor] for the reduced amount of the secured claim. Thus, they have an increased chance to retain their homestead. On the other hand, if §506 is not applied and the property is not liquidated, the [homeowners] will hold a mortgage exceeding $200,000 on property allegedly worth $38,000. The [homeowners] would have little incentive to remain on the property, since [the homeowners] could only get a good title after paying far more than what the property is worth. This is especially true since the [creditor] could foreclose at any time and realize whatever equity the [homeowners] had generated.

Gaglia, 889 F.2d at 1308; see Folendore, 862 F.2d at 1540.

Moreover, the fresh start implies that debtors must not be strapped with

undersecured, unsecured or disallowed prepetition debt. In most states, any creditor can demand a second, third or even fourth mortgage on a debtor's home in most consumer credit transactions even where the debtor's residence is already fully encumbered. If the debtor later files a chapter 7 bankruptcy case and is not permitted to strip down the wholly or partially unsecured mortgages, creditors will have succeeded in circumventing the bankruptcy discharge by immunizing themselves from the discharge. After the bankruptcy case, with the mortgage liens still in place, creditors can threaten to schedule a foreclosure if the entire debt is not paid. Faced with these threats a debtor often will pay the entire debt even though in reality it is completely or partially unsecured and should have been discharged to that extent. See Gaglia, 889

F.2d at 1308-9; Lindsey, 823 F.2d at 191.

This fresh start principle in no way prejudices prudent mortgage lenders. The ratio of collateral value to loan amount which a mortgage lender approves when it agrees to extend a loan is solely within a mortgage lender's control. Hougland, 886 F.2d at 1184. As the 9th Circuit noted, "[O]ne would think that most residential real estate lenders would see to it that they had a sufficient cushion to avoid finding themselves in an undersecured position." Hougland, 886 F.2d at 1184.

In fact, most purchase money mortgages are amply secured due to the combined effect of payments by mortgagors and appreciation of housing values. In re Caster, 77 B.R. 8, 13 (Bankr. E.D. Pa. 1987). To the extent any mortgage lender is undersecured, the lender in the bankruptcy will share in the distribution with other unsecured creditors.

III. THE COURT OF APPEAL'S ARGUMENTS FOR EVISCERATING §506 ARE WRONG AND LEAD TO ABSURD RESULTS

The court below offers several reasons for deviating from the plain language of the statute and for refusing to avoid undersecured liens. None of the reasons advanced by the lower court justify the repudiation of the plain language of the statute.

A. The Construction Given to §506(a) By The Court Below Deprives That Section of Any Meaning and Would Lead to Nonsensical Results

1. The court below adopted inconsistent interpretations of statutory terms depending upon the results it desired.

Attempting to avoid the readily apparent meaning of the plain language of the statute discussed above, the court of appeals in this case adopted its own "plain language" interpretation of §506(a), an interpretation which must be described as strained, to say the least. Although the estate clearly had an

interest in the property involved at the time of the §506 proceeding in the bankruptcy court, the court found that the property was not property in which the estate had an interest because it was abandoned at some point later in the case. Dewsnup, 908 F.2d at 591. At the same time, the court held that in chapter 11, 12 and 13 cases the estate has an interest in property even after it is abandoned. Id.

To arrive at this result, the court below seems to have used a shifting and elusive definition of the word "interest" in §506. On the one hand, in deciding that the estate had no interest in the property after it was abandoned in a chapter 7 case, the court appears to have adopted a meaning limited to a property interest belonging to the estate throughout the duration of the bankruptcy case. On the other hand, by holding that a

chapter 11, 12 or 13 estate still has an interest in the property after it is abandoned, the court appears to adopt some other meaning, because the estate has no more of a property interest after abandonment in those chapters than it does in chapter 7.

This second meaning is never made entirely clear by the court below, but it seems broader than the concept of property of the estate. It is apparently an interest in property other than a pure property interest, and is implicated if the debtor proposes to "deal with and affect abandoned and/or exempted property". Id.

Certainly, neither §554 of the Code nor any other specific section of the Code provides for differing effects of abandonment, or differing meanings of the term "interest" in §506, depending upon the chapter in which it is applied. The court below cites no

authority for its odd conclusions in this regard. It would be strange indeed if Congress had desired the same word in the same provision to have two different meanings, an approach which is hardly consistent with the "plain language" doctrine that the court below claimed to be embracing or with §103(a), making §506 and §554 generally applicable in all chapters."[12]

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[12] There is no need to decide between these two possible meanings of "interest" if the Court looks simply to the property interest of the estate as of the time the case is commenced, when creditors' rights are generally fixed. See Part II. B. supra.

2. The holding below would prevent application of §506(a) where Congress obviously intended it to be applied.

It is not surprising, however, that the court below felt the need to "save" chapters 11, 12 and 13 from its interpretation of the language of §506(a). Since §554 is applicable to all Code chapters, property can be abandoned in those chapters just as it can be abandoned in chapter 7. And, under the lower court's interpretation of §506(a) for chapter 7 cases, an undersecured creditor might then have no allowed secured claim that could be provided for in a chapter 11, 12 or 13 case. Since providing for allowed secured claims is among the most important functions of a plan under those chapters, it would make no sense at all to read §506(a) in cases under chapters 11, 12 and 13 as the court below read it for chapter 7 cases. See 11 U.S.C. §§1129(b)(2), 1225(a)(5), 1325(a)(5).

Under the holding below, §506(a) also could not be applied where there were distributions to unsecured creditors from other estate property so that undersecured creditors could realize some value based upon their deficiency claims. See discussion at part II. B. supra.

Even §722, which the court below points to as the debtor's only remedy with respect to overencumbered property in chapter 7, would make no sense under that court's reading of §506(a). Under §722, the debtor may redeem **abandoned** personal property by paying to the holder of the lien "the amount of **the allowed secured claim** of such holder...." (emphasis supplied). Yet, under the lower court's interpretation of §506(a), there could either never be a determination of the allowed secured claim under §506(a) or else that allowed secured claim would be zero in every

chapter 7 case.

As one bankruptcy court explained, this anomalous result would be the logical conclusion if §506(a) was read to exclude property that was exempted or in which the estate's interest might be ultimately abandoned:

> I also think [the creditor's] argument really goes farther than it would like. If its reading is correct, then since the estate now has no interest and since §506 says that a claim is a secured claim only to the extent of the creditor's interest in the estate's interest in such property, then since the estate's interest is zero, the creditor's interest is zero and therefore [the creditor] does not have any allowed secured claim. Therefore under §506(d) its lien is completely void as would be the liens of all creditors secured on exempt property. Obviously, Congress never intended that result.

In re Gibbs, 44 B.R. 475, 479 (Bankr. D. Minn. 1984).

Finally, having the right to utilize §506 turn on the abandonment of property would have

peculiar results unrelated to any possible Congressional policy. It would create a race to the courthouse, with the debtor or the trustee seeking to obtain a final determination under §506(a) before a party could move that the property should be abandoned.[13] It is hard to imagine any reason Congress would have wanted to encourage such a race or to have the right to invoke §506 depend upon who won.

There would also be litigation over whether the property should be abandoned, since debtors would argue that property of the estate clearly includes exempt property that should be preserved for the debtor's fresh

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[13] The trustee may abandon property only after notice and a hearing. 11 U.S.C. §554(a). Any other party seeking abandonment of property must file a motion to be decided by the court. 11 U.S.C. §554(b).

start.[14] There is no question that the debtor would usually have at least equitable and possessory interests, as well as a legal title interest in the property, which could be exempted. See United States v. Whiting Pools, Inc., 462 U.S. 198, 204-5 (1983).[15] Again, it

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[14] In enacting the Code, Congress made clear that, unlike under the former Bankruptcy Act, property of the estate under the Code includes exempt property. The broad definition of property of the estate in 11 U.S.C.§§541(a) was intended to have the effect of overruling Lockwood v. Exchange Bank, 190 U.S. 294 (1903), which had held that under the former Act exempt property was not property of the estate. See H.R. Rep. 95-595 at 368.

[15] In Whiting Pools, this Court rejected a restrictive approach to the debtor's rights similar to that espoused by the court below. As in this case, a secured creditor argued that the Code's turnover provision, §542, could be applied only with respect to property rights the estate possessed at the time and could not expand the debtor's rights, even with respect to possession. This Court rejected that crabbed interpretation, which it found would have rendered §542 virtually superfluous. See 462 U.S. at 207, n.15. Similarly, as argued herein, the approach of

(continued...)

is difficult to see what possible policy would be served by encouraging such litigation, which would serve no useful purpose.

All of the above problems and inconsistencies result only if this Court adopts the strained reading of §506 accepted by the court below. Only a handful of courts, at most, have adopted this reading of the statute, with the applicability of §506 dependent on whether property has been, or could in the future be, abandoned. As discussed above, all other courts of appeals to address the issue have reached a different conclusion, which creates none of the anomalous results that would necessarily follow from the ruling of the court below.

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[15](...continued)
the court below in this case would render §506(a) largely meaningless in chapter 7 cases as well as many other cases.

B. The Provisions of §722 are Consistent with the Plain Language of §506(d) and with the Voiding of Liens on Abandoned Property in a Chapter 7 Case

The court below concluded that the presence of §722 in the Code supported its refusal to apply the plain language of §506(d). Dewsnup, 908 F.2d at 590 and 592 (allowing avoidance pursuant to §506(d) renders the redemption provision in §722 meaningless and permits the redemption of real property not intended by §722). In fact, §722 provides no support for the lower court's tortured reading of §§ 506(a) and (d).

There is simply no inconsistency between the plain language of §722 and the provisions of §506(d) and no mention, either in the language of the Code or in the legislative history, that Congress intended §722 to preempt the treatment of secured claims in

chapter 7 cases."[16] In re Mays, 85 B.R. 955,

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[16] To the contrary, in his testimony before both the House and the Senate opposing the inclusion of a separate right of redemption, Linn K. Twinem, Esquire, a creditor's representative, described the procedure for limiting secured claims to the value of the collateral under a provision that was to become §506(d) and then stated:

> To give the debtor **still another type of additional protection,** it is proposed that a debtor be allowed to redeem collateral security [sic] a discharged consumer debt by paying its appraised value if such value is less than the amount of the debt.

Hearings Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary on H.R. 31 and 32, 94th Cong. 1st & 2d Sess. 904 (1975) (Statement of attorney Linn K. Twinem on behalf of the Beneficial Finance System) (emphasis added); Hearings Before the Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary on S. 235 and S. 236, 94th Cong. 1st Sess. 192 (1975).

Throughout the extensive reports and hearings preceding the 1978 enactment of the Code, counsel can find no report, testimony or commentary on the right of redemption for consumer goods which suggests that the right of redemption was considered to be an exclusive remedy.

959 (Bankr. E.D.Pa. 1988), aff'd 1988 U.S. Dist. Lexis 8427 (E.D. Pa. August 1, 1988); (cited with approval in Gaglia, 889 F.2d at 1310); Gibbs, 44 B.R. at 478. In fact, §722 itself would not make sense if liens on abandoned property were not void under §506(d).

The court below correctly observed that §722 is a redemption statute. Dewsnup, 908 F.2d at 592. It failed, however, to observe that §506(d) is not. Gaglia, 889 F.2d at 1310; Folendore, 862 F.2d at 1540. Section 722 was included in the Code to provide debtors with certain affirmative redemption rights that they might otherwise not have under applicable non-bankruptcy law. H.R. No. 95-595 at 380-381. It also provides debtors with a simplified procedure to effectuate redemption in the bankruptcy court. Mays, 85 B.R. at 959; see 4 Collier at ¶722.05.

In the absence of §722, debtors in many cases would have no state law right to prevent their property from being sold to satisfy a secured debt by paying the value of the property. The right to redeem repossessed collateral under §9-506 of the Uniform Commercial Code simply provides debtors the right to recover repossessed property by paying the entire contractual amount due plus expenses, attorney's fees and legal expenses. U.C.C. §9-506. When repossessed collateral is sold, debtors do not even have the right to be present at the sale. They have no right of first refusal, i.e. no guarantee that they will be able to purchase the collateral at its fair value. See U.C.C. §§9-504(a) and (c).

Section 722 provides debtors with the right of first refusal, the right to repurchase the property for what it is worth. H.R. Rep. 95-595 at 381. 4 Collier at

¶722.01[1].

In contrast §506(d) simply determines the extent to which a creditor's lien will survive the bankruptcy. See In re Crouch, 76 B.R. 91, 93 (Bankr. W.D. Va. 1987). It in no way effects or modifies the creditor's right to enforce that lien after the bankruptcy is over. Gaglia, 889 F.2d at 1310; Lindsey, 823 F.2d at 191.

In this respect §506(d) is not unique, as it is but one of many chapter 5 provisions that speak to which liens will and will not survive the bankruptcy. See e.g. §522(f)(1)(avoidance of judicial liens on exempt property); §522(f)(2)(avoidance of certain non-possessory non-purchase money liens on exempt property). See also §§ 522(g),(h) and §545 (avoidance of certain statutory liens); §547 (avoidance of certain preferential transfers including the creation

of liens under certain circumstances); §548 (avoidance by the debtor of certain involuntary transfers, including the creation of liens that are not for fair value).

Though none of these provisions are intended as redemption provisions, they could all enable a debtor to essentially redeem liened property, including real property, that is not covered by §722. The reasoning of the court below that §722 is the debtor's exclusive remedy in a chapter 7 case for dealing with secured creditors would, if taken to its logical conclusion, require the lien avoidance provisions, in §§522(f)(1), and (2) and in the numerous other provisions of the Code mentioned above, to be unavailable to chapter 7 debtors. This reasoning is, in the words of one bankruptcy court, "not only dangerously presumptive, but plainly wrong". Mays, 85 B.R. at 959.

When pointing to §722 as support for its refusal to apply §506(d), the court below conveniently ignores the problems which its reading of §506(d) creates in the operation of §722. As is briefly pointed out above in Part III. A. 2., these problems render §722 meaningless as applied to abandoned property.

The redemption rights created by §722 apply to certain property that is subject to a "**lien** securing a dischargeable consumer debt, if such property is...abandoned under §554..." (emphasis added). The amount the debtor must pay to the holder of the lien to redeem the property pursuant to §722 is "the amount of the **allowed secured claim** of such holder that is secured by such lien." (Emphasis added).

Section 722, by its plain language, requires the application of §§506(a) and (d) in order to determine the extent of the "allowed secured claim" and thus the extent of

the "lien" from which the property must be redeemed. If §§506(a) and (d) are not applicable to abandoned property in a chapter 7 case, §722 itself cannot be applied to abandoned property."

At the same time, the status of the creditor's lien on the property would remain in doubt, even when the collateral had virtually no value, since, according to the lower court, §506(d) is unavailable to void any part of a lien on abandoned property. Debtors would be left to state court to assert that a creditor's lien was extinguished by the redemption.

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[17] As was pointed out above in Part III. A., the result is nonsensical - either §722 could never be applied to abandoned property, despite the explicit language making it applicable to such property; or the amount the debtor would have to pay to redeem abandoned property would be zero in every chapter 7 case.

In the final analysis, the lower court's reading of §506(d) would completely obliterate the benefits of §722. This is, of course, not what Congress intended. Further, §722 provides no support for the lower court's construction of §506(d). Accord 4 Collier at ¶722.01. It simply provides additional support for applying §506 in accordance with its plain meaning under all chapters of the Code.

C. The Use of §506 Does Not Enable Chapter 7 Debtors to Receive More Than They Would Receive in a Bankruptcy Reorganization

The court of appeals also found that if chapter 7 debtors are permitted to use §506 to void liens on real property, they will file chapter 7 petitions instead of chapter 11 and 13 petitions, since they supposedly will be gaining more than they could in those chapters. This practice, the court concluded, would eviscerate Congress' preference for

reorganization rather than liquidation. Dewsnup, 908 F.2d at 592.

The lower court is simply wrong that chapter 7 debtors in fact fare better in a chapter 7 as to the application of §506(d) and further, that §506 lien avoidance is the sole reason a debtor would choose, even if qualified for other chapters, to file a chapter 7 petition.

To be sure, the Bankruptcy Code contains inducements for a debtor to choose a reorganization over a liquidation which demonstrates a Congressional preference for debtors to chose the former. However, chapter 7 remains in the Bankruptcy Code as well and retains important purposes such as providing the debtor with a fresh start. Obviously not all debtors qualify for chapter 13 and many are not eligible for chapter 11. Chapter 7 therefore is the only place for these debtors

if they are to obtain a bankruptcy fresh start.

More importantly, the voidability of liens is only one of many factors a debtor considers when choosing between bankruptcy chapters. "Each chapter contains its own special inducements and restrictions and must be evaluated as a whole." Gaglia, 889 F.2d at 1311, (quoting In re O'Leary, 75 B.R. 881, 884 (Bankr. D.Or. 1987)). It is the experience of counsel, who have been utilizing §506 in both chapter 7 and chapter 13 in our representation of debtors, that only rarely do debtors file a chapter 7 bankruptcy primarily to take advantage of 11 U.S.C. §506. To the contrary, most of the cases we file on behalf of debtors who wish to save their homes from foreclosure are chapter 13 cases. We do so to enable debtors to effectively cure or pay off delinquent mortgages through their chapter 13

plans in ways which are unavailable under chapter 7 of the Code.

Every court of appeals, including the 10th Circuit, which has addressed the interplay of §506 and Chapter 13 has held that debtors pursuant to §506 may void all undersecured liens on real property in chapter 13 and that debtors may even modify the contract terms of the remaining secured claims on their homes if the claim is secured by more than the realty itself. Hart 923 F.2d at 1411; Wilson, 895 F.2d at 127-8; Hougland, 886 F.2d at 1183; see generally Collier at ¶1300.73 and ¶1322.06 (claims on debtors' home may be bifurcated and unsecured portions modified in a chapter 13).

In a chapter 7 case, debtors may void the unsecured part of a real property lien but may not modify the remaining secured claim, except as may be provided by applicable state law.

Chapter 7 debtors cannot cure a delinquency on the lien nor may they force the lienholder to accept payment of the allowed secured claim over time, as is permitted in chapter 13. 11 U.S.C. §§1322(b)(3), (5), and (6). As Judge Posner pointed out:

> [O]nce the strip downs were complete and the secured claims allowed in their stripped down amount, . . . the only thing that remained to do in the bankruptcy proceeding was to discharge the debtors and let the creditor, foreclose their stripped-down liens, subject to whatever rights of redemption the debtors may have, under state law, in the foreclosure proceedings . . . The [debtors] forget that they chose to proceed under Chapter 7 of the Bankruptcy Code . . . If the [debtors] wanted to hold on to their property they should have sought reorganization under Chapter 13. In reorganization secured creditors may be prevented from foreclosing; may be forced to substitute a new security interest for their original interest. . .

Lindsey, 823 F.2d at 191; see also, Gaglia, 889 F.2d at 1310.

Likewise in a chapter 11 case, there is nothing, for the most part, which enables

creditors to escape a §506 determination. Creditors' claims are determined for secured status and liens are voided to the extent undersecured. 11 U.S.C. §§ 103(a), 506(a) and (d). See Tarnow, 749 F.2d at 465. As stated in Part I. B. supra, the one exception exists for nonrecourse creditors under certain circumstances. 11 U.S.C. §1111(b)(2).[18]

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[18] It should be noted that respondents are recourse creditors.

IV. CONCLUSION

Since the plain meaning of 11 U.S.C. §506 mandates that chapter 7 debtors may void liens to the extent undersecured, regardless of whether the property has been abandoned, and since such a reading furthers the purposes and policies of the Bankruptcy Code, amicus curiae requests this Court to reverse the judgment of the court of appeals.

Respectfully submitted,

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